FOREIGN ACTIVITY

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

Vol. XVI, No. 4 August 8, 1991

Internationalization Continues

A combination of economic and world events set the back-drop for foreign activity in 1Q91. Declining interest rates, a soaring dollar, and a stunning victory in Iraq by U.S.-led coalition forces, created a positive atmosphere for investment in U.S. securities. For the first time since the third quarter of 1989, foreign investors were net purchasers of U.S. equities, $2.5 billion. U.S. investors, continuing the substantial acquisitions of the past two years, added $10 billion of foreign securities to their portfolios in 1Q91.

Foreign Activity In U.S. Equities

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS
($Mils.)

	FOURTH QUARTER 1990		*FIRST QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q91-4Q90*
EUROPE	**$39,354**	**($2,484)**	**$52,847**	**($1,153)**	**34.3%**
BELGIUM-LUXEMBOURG	2,519	(175)	3,412	(14)	35.5%
FRANCE	2,737	(288)	3,669	82	34.1%
GERMANY	2,173	(245)	3,424	(318)	57.6%
NETHERLANDS	1,362	(86)	2,498	(128)	83.4%
SWITZERLAND	5,559	(645)	9,400	(808)	69.1%
UNITED KINGDOM	21,332	(820)	25,999	(99)	21.9%
CANADA	**9,736**	**650**	**11,822**	**778**	**21.4%**
LATIN AMERICA & CARIBBEAN	**12,272**	**(346)**	**15,098**	**1,174**	**23.0%**
BERMUDA	2,953	224	2,307	45	(21.9%)
NETHERLANDS ANTILLES	3,799	(573)	5,410	934	42.4%
ASIA	**17,468**	**(3,583)**	**22,806**	**1,824**	**30.6%**
HONG KONG	2,389	(222)	2,337	397	(2.2%)
JAPAN	11,367	(1,711)	13,340	(640)	17.4%
OIL EXPORTING COUNTRIES	2,940	(1,239)	4,245	366	44.4%
TOTAL ALL COUNTRIES*	**$80,875**	**($5,876)**	**$104,586**	**$2,496**	**29.3%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

Securities Industry Association
120 Broadway, New York, NY 10271 • (212) 608-1500 • Fax: (212) 608-1604
1850 M Street, NW, Washington, DC 20036 • (202) 296-9410 • Fax: (202) 296-9775
Annual Subscription: $40 member • $60 non-member • additional $12 outside of U.S. and Canada

Foreign investors returned to the U.S. equity market in 1Q91, with net purchases of $2.5 billion. This follows a stretch of five consecutive quarters of net sales totalling $15.8 billion. In a geographic sense, however, the appeal of U.S. equities was not widespread. European investors continued to sell-off U.S. equities, with net sales for the quarter totalling $1.15 billion. Among the European countries reviewed, only France made net purchases, and a mere $82 million at that. The following table illustrates that European investors have been significant sellers of U.S. equities for over a year. While 1990's divestitures were dollar related, the European markets were down 6.1% during this period in contrast to a 6.3% gain for U.S. markets. Nevertheless, despite generally declining domestic markets, European investors looked at home for growth prospects and sold on dollar weakness.

Net Activity By European Investors In U.S. Equities, 1990-1Q91

($Bils.)

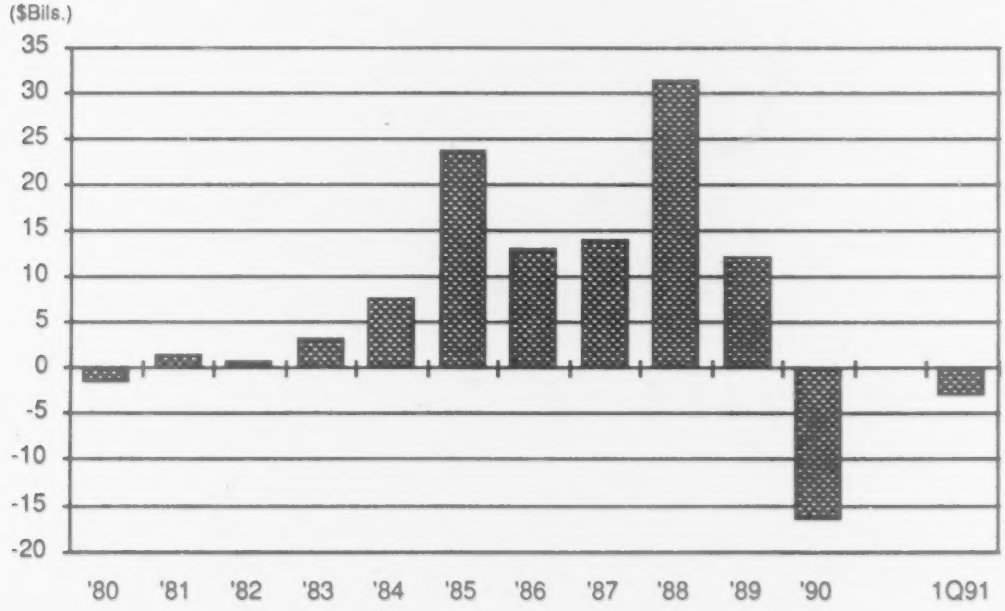
Europe	(9,732)
Belgium-Luxembourg	(750)
France	(1,101)
Germany	(688)
Netherlands	(535)
Switzerland	(3,692)
United Kingdom	(3,221)

Canadian investors made substantial acquisitions of U.S. equities in 1Q91. Indeed, the first-quarter takedown of $778 million nearly matched last year's total acquisitions of $890 million. For the last three quarters, Canadian acquisitions of U.S. equities total $2.1 billion, making these investors the largest foreign purchases of equities.

Several reasons may help to explain this posture. Relatively speaking, the Canadian equity market has performed "poorly." For example, Canadian equities rose about 5.2% in 1Q91 compared to a 14% rise in U.S. equity prices. Indeed, this follows a decade where Canadian equity prices rose at an annual rate of about 6%. Second, new Canadian regulations allow for increased allocation of foreign securities to Canadian pension fund portfolios. Thirdly, as noted in an earlier issue of SIA's *ICMR*, the foreign assets held by Canadian investors grew by only 7% in the 1984-1989 period, compared to about 15% growth in U.S. holdings and 30% in Japanese holdings. Canadian investors may be attempting to more heavily weight their portfolios with foreign assets.

Investors from Asia made U.S. equity acquisitions of $1.8 billion. However, the 1990s are continuing to make the story of the 1980s, that of Japanese investment in U.S. equities, look like a historical artifact. Coming on top of 4Q90 equity divestitures of $1.7 billion, these investors made net sales of $640 million in 1Q91. In a broader context, the exit of the Japanese investor from U.S. securities has been just as swift as their entry. Since the large inflows of the mid-1980s, Japanese investors have seen their U.S. portfolios rocked by a 42% dollar decline, which nearly wiped out a 56% rise in the S&P 500 during the period. Similarly, according to the *Salomon Brothers World Government Bond Index*, Japanese investors received a cumulative Yen-based total return in U.S. government bonds of 4.1% from end-1985 to end-1989. While undoubtedly some of the currency risk was hedged, the Japanese investors found themselves swimming up-stream from the mid-to-late 1980s. However, we would be naive not to acknowledge the current "scandal" in the Japanese markets and the sharp plunge in equity prices causing many Japanese to sell foreign holdings and focus on their domestic market.

Japanese Net Purchases
Of U.S. Securities



Some support for the U.S. market came from Hong Kong, $397 million, and OPEC, $369 million. However, the largest support came from Singapore, with net acquisitions of $1.7 billion. Given the serious restrictions on foreign investment on Singapore residents, it is likely that official institutions were the acquirers.

Foreign Investment In U.S. Treasuries

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

	FOURTH QUARTER 1990		*FIRST QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q91-4Q90*
EUROPE	**$392,248**	**$6,776**	**$441,492**	**$1,722**	**12.6%**
GERMANY	28,284	2,829	29,917	(5,806)	5.8%
SWITZERLAND	6,936	813	9,442	778	36.1%
UNITED KINGDOM	263,173	(3,121)	287,922	3,288	9.4%
ASIA	**384,222**	**(6,193)**	**435,272**	**3,608**	**13.3%**
JAPAN	327,097	(7,619)	362,311	(2,821)	10.8%
OIL EXPORTING COUNTRIES	19,433	(1,111)	23,063	(318)	18.7%
NONMONETARY INT'L & REGIONAL ORG'S	**56,792**	**285**	**44,110**	**(1,082)**	**(22.3%)**
TOTAL ALL COUNTRIES*	**$924,221**	**$11,313**	**$1,129,240**	**$870**	**22.2%**

Source: U.S. Treasury
* Activity incorporates revised data

Net activity in U.S. Treasuries sank to under $900 million in 1Q91, while transactions climbed over 22% to $1.1 trillion. The net numbers mask an interesting story—official institutions bought $13.2 billion of U.S. Treasuries in February, only to make net sales of a whopping $15.3 billion in March. February's net purchases may have been to prop up the U.S. dollar in the wake of an increase in official German interest rates and a cut in U.S. rates. However, in mid-February, the dollar began a long-anticipated rise against major foreign currencies. March net sales were a sign of coordinated intervention by the G-7 countries to cap the rise of the dollar. The speed of the rise, particularly against the DM, may have jolted central bankers into massive selling of the dollar.

German investors made net sales of U.S. Treasuries totalling $5.6 billion in 1Q91, nearly offsetting last year's net purchases of $5.7 billion. The size of these divestitures suggests that the German central bank did indeed make substantial dollar sales in order to slow, if not stop, the rise of the greenback.

Flows Into The U.S. Treasury Market, 1Q91-1990

($Bils.)

Largest Acquirers		*Largest Divestors*	
Spain	10.5	Japan	(17.7)
Taiwan	7.0	Int'l Orgs	(1.6)
Netherlands Antilles	6.9	Oil Exporting Countries	(0.7)
Mexico	2.8	France	(0.6)
Denmark	2.8	Korea	(0.3)
United Kingdom	2.0	Venezuela	(0.2)

Support for the U.S. Treasury market came from countries not often associated with large U.S. inflows. Spain, last year's largest buyer of U.S. Treasuries at $6.8 billion, made net purchases of $3.7 billion. Some of this support may have come from the Spanish central bank, which at the end of March 1991 held a considerable $49.9 billion in foreign exchange reserves. Coincidentally, at the beginning of 1990, Spanish foreign exchange reserves totalled $39.5 billion, about $10.5 billion less than March 1991's $49.9 billion.

A number of factors stemming from developments in 1989 may also help explain the Spanish private investor's interest over the past year. For one, the Spanish decision to join the EMS reduced the volatility of the peseta relative to other European currencies. Second, an increase in the withholding tax on government bonds made Spanish fixed-income instruments relatively less attractive. Third, a credit ceiling was imposed on Spanish bank lending to the private sector. These three factors all had the impact of reducing returns at home and forcing Spanish investors to look elsewhere for a higher yield.

Finally, prior to November 1989, Spanish banks were forced to make obligatory deposits to hold against their foreign exchange positions. (A deposit of 20% of any increase in foreign exchange position must be held.) The abolition of this requirement in November made foreign currencies, as well as foreign bonds, more attractive to hold.

U.S. Investment In Foreign Securities

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

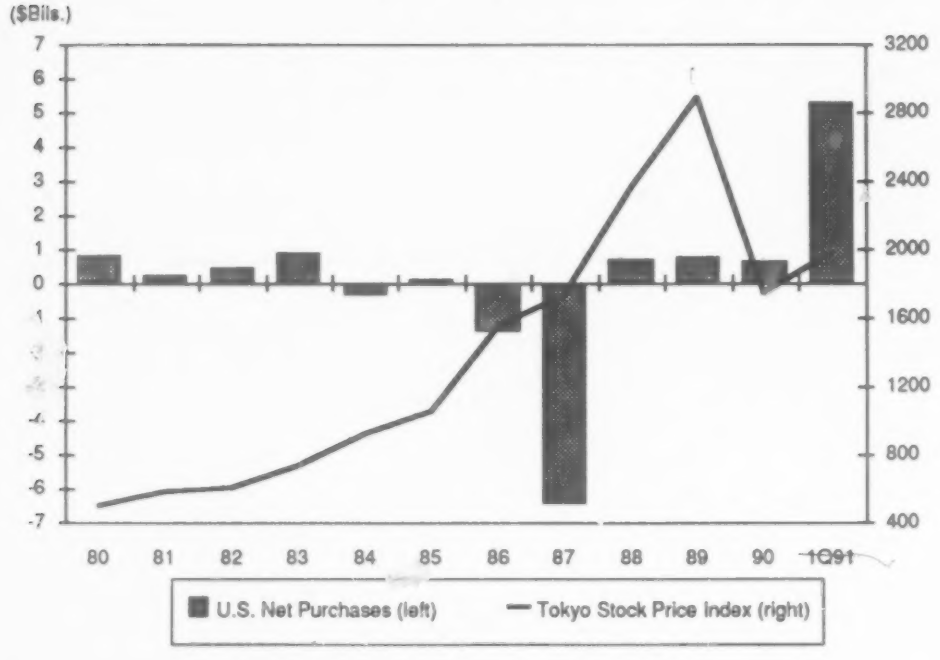
	FOURTH QUARTER 1990		*FIRST QUARTER 1991*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q91-4Q90*
EUROPE	**$31,589**	**($589)**	**$36,958**	**$2,332**	**17.0%**
EUROPEAN COMMUNITY	*$29,200*	*($510)*	*$33,269*	*$1,761*	*13.9%*
BELGIUM/LUXEMBOURG	451	13	471	(35)	4.4%
DENMARK	90	16	132	30	46.7%
FRANCE	2,209	73	2,618	106	18.5%
GERMANY	2,416	272	3,203	645	32.6%
GREECE	26	6	8	2	(69.2%)
IRELAND	23	(1)	52	(30)	126.1%
ITALY	967	(81)	1,676	252	73.3%
NETHERLANDS	2,080	330	1,975	(187)	(5.0%)
PORTUGAL	20	4	10		(50.0%)
SPAIN	791	(151)	1,250	128	58.0%
UNITED KINGDOM	20,127	(991)	21,874	850	8.7%
SWITZERLAND	1,532	(50)	2,456	290	60.3%
CANADA	**1,982**	**(162)**	**2,709**	**(385)**	**36.7%**
LATIN AMERICA & CARIBBEAN	**2,268**	**720**	**2,417**	**(241)**	**6.6%**
MEXICO	749	497	532	146	(29.0%)
ASIA	**17,094**	**606**	**18,853**	**5,275**	**10.3%**
JAPAN	13,582	250	15,996	5,230	17.8%
OTHER	**1,322**	**507**	**1,153**	**43**	**(12.8%)**
TOTAL ALL COUNTRIES*	**$54,255**	**$1,082**	**$62,658**	**$6,886**	**15.5%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

With the stimulus provided by a sweeping victory in the Mid-East and declining short-term interest rates, U.S. equities posted a 1Q91 total return of 15.1%. Despite the broad scope of the U.S. market surge, U.S. investor interest in foreign equities continued unabated. Indeed, U.S. acquisitions of foreign equities in 1Q91 reached a quarterly record $6.9 billion. Surprisingly, the lion's share of U.S. capital, nearly $5.3 billion, was sent to Japan.

U.S. investors were barely bit players in Japanese equities in the 1980s. During this period, U.S. investors not only watched the Tokyo Stock Index (local terms) increase over 6 times but actually divested $4.2 billion worth of Japanese equities. Despite a near 40% decline in Japanese equity prices in 1990, U.S. investors made acquisitions of $5.3 billion in 1Q91.

U.S. Net Purchases Of Japanese Equities



U.S. investors used a similar strategy in Germany. After watching German equity prices end 1990 down 28% from their March 1990 peak, U.S. investors made net purchases of $645 million, their second highest level over. While the future cost of a unified Germany continues to cloud any investment strategy, U.S. investors, as highlighted by their dollar commitments, are keeping a foot in the door.

Mexican equities continued as a U.S. investment favorite. An additional $146 million was invested in Mexican shares, bringing the most recent five-quarter takedown to almost $1.7 billion. During this 15 month period, Mexican equity prices rocketed 170% (142.7% in U.S. dollars).

Despite a 5% increase in Canadian equity prices in 1Q91 (a global basket returned 14%), U.S. investors continued to move out of Canadian equities as concern over the depth of the Canadian recession grew. Net sales in 1Q91 totalled $385 million. High interest rates and a recession have made U.S. and foreign investors adopt a cautious stand toward Canadian equities.

U.S. interest in foreign fixed-income products also continued. After making acquisitions of over $22 billion last year, investors purchased another $3.1 billion in 1Q91. However, 1990's impressive returns on foreign bonds were not to be found in 1Q91. Indeed, the best performers of last year, which showed returns of over 20%, slipped into the negative in 1Q91 as the surging U.S. dollar led to currency losses.

Substantial acquisitions of French bonds have been made recently, over $3 billion during 4Q90 and 1Q91. As with other European fixed-income instruments, French bonds offered generous yields last year. Combined with an increase in the French franc relative to the dollar, French bonds showed a total return of 23.5% (U.S. $ terms) in 1990; the third best performing bond market for U.S. investors. However, the dollar's surge in 1Q91 transtated to a reversal in the U.S. investor's fortune: while French bonds rallied, French bonds returned (7.0%) to U.S. investors.

1Q91 Total Rates Of Return For Selected Government Bond Markets

	U.S. $	*Local Currency*
C$	6.17	5.98
A$	5.59	5.19
U.S.$	2.00	2.00
¥	(2.16)	1.99
£ Sterling	(4.17)	6.53
Ffr	(6.96)	6.05
Dfl	(9.30)	3.67

Source: Salomon Brothers Inc

Canadian fixed-income instruments have lately been a staple of U.S. investors. First-quarter net acquisitions of $1.8 billion followed last year's record takedown of about $6.8 billion. As the spread between Canadian governments and U.S. bonds has increased over the past few years, particularly in real terms, Canadian bonds have become increasingly attractive.

David G. Strongin
Director, International
Finance

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN BONDS BY U.S. INVESTORS
($Mils.)

	FOURTH QUARTER 1990		FIRST QUARTER 1991		% CHANGE
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	IN GA 1Q91-4Q90
EUROPE	**$126,117**	**$443**	**$135,838**	**$714**	**7.7%**
EUROPEAN COMMUNITY	$118,533	$251	$127,847	$587	7.9%
BELGIUM/LUXEMBOURG	2,762	(142)	3,927	173	42.2%
DENMARK	1,644	284	3,372	(174)	105.1%
FRANCE	12,712	1,504	11,272	1,538	(11.3%)
GERMANY	9,546	1,036	12,230	(1,918)	28.1%
GREECE	1	**	48	(26)	**
IRELAND	667	101	398	(16)	(40.3%)
ITALY	4,747	49	5,295	283	11.5%
NETHERLANDS	7,337	859	3,873	453	(47.2%)
PORTUGAL	28	(26)	47	(41)	67.9%
SPAIN	1,118	(240)	1,991	197	78.1%
UNITED KINGDOM	77,972	(3,174)	85,394	118	9.5%
SWITZERLAND	2,781	11	2,773	(43)	(0.3%)
CANADA	**22,855**	**2,921**	**20,001**	**1,753**	**(12.5%)**
LATIN AMERICA & CARIBBEAN	**9,778**	**1,420**	**11,995**	**(539)**	**22.7%**
MEXICO	365	101	235	15	(35.6%)
ASIA	**42,985**	**943**	**36,222**	**(170)**	**(15.7%)**
JAPAN	36,018	1,092	28,028	650	(22.2%)
OTHER	**8,352**	**1,670**	**8,055**	**1,351**	**(3.6%)**
TOTAL ALL COUNTRIES*	**$210,087**	**$7,397**	**$212,111**	**$3,109**	**1.0%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions
** Less than $1000